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SUBJECT: UKRAINE: SUPREME COURT RULES AGAINST PROPORTIONAL
SHAREHOLDER RIGHTS IN TELENOR CASE

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¶1. (SBU) Summary. The Commercial Chamber of Ukraine's Supreme Court ruled on October 3 in favor of a lower court's finding that mobile phone operator KyivStar's shareholders are entitled to equal representation on the company's Board of Directors, regardless of how many company shares each shareholder may hold. The Court made the counterintuitive decision in a highly publicized dispute between mobile phone operator KyivStar's two sole shareholders -- the Norwegian mobile phone company Telenor and Storm, a 100% subsidiary of the Russian Alfa Group. This ruling could seriously damage Ukraine's investment climate and encourage corporate raiders who already use Ukraine's weak courts to execute questionable takeover schemes. End Summary.

¶2. (SBU) The October 3 Supreme Commercial Court hearing, which Econoff attended, was the latest of nine Ukrainian court cases that Alfa Group's Storm had filed as part of a long-running shareholders' dispute with Telenor. Storm petitioned the Ukrainian courts to declare the KyivStar Shareholders' Agreement invalid and to recognize Storm's 43.5% share in the company as entitling it to representation on the Board of Directors equal to that of Telenor, which held 56.5% of the company. In this manner, Storm hoped to gain greater control over KyivStar, Ukraine's #1 mobile phone operator. (Note: KyivStar's revenues for the first six months of 2006 topped \$757 million.) Telenor management told the Embassy on September 20 that Storm also had blocked KyivStar Board of Directors and shareholders meetings for a year and a half (by failing to show up for meetings) in an effort to force out Telenor.

¶3. (SBU) In the lead-up to the hearing, Telenor launched a country-wide media campaign warning of the dire affects an adverse ruling could have on other foreign businesses in Ukraine. Then-Chief of the Presidential Secretariat Oleh Rybachuk made a public statement on September 6 echoing Telenor's warnings. Despite the publicity, the October 3 proceeding, at which representatives of the U.S. and Norwegian embassies were present, was over surprisingly quickly. The panel of judges rejected out of hand Telenor's motions to prevent their hearing of the case, then proceeded to arguments. After 20 minutes of deliberation, the judges announced their decision, raising doubts among observers whether the issue was decided in advance.

¶4. (SBU) The decision reversed, apparently on procedural grounds, a Higher Economic Court decision of June 27 in favor of Telenor. That June 27 decision had itself reversed the Higher Economic Court's own December 22, 2005 decision declaring a number of Kyivstar's Shareholder Agreement statutes illegal and granting Storm equal representation rights on the Board of Directors. The Commercial Chamber's ruling on October 3 reinstated the original December 22 decision, leaving Telenor with no higher court of appeal. Telenor told us it would file suit on the matter in New York, designated in the Kyivstar Shareholders Agreement as the venue for arbitration of disputes. Telenor also told us it will work around the decision by subdividing its shares among five wholly-owned and specially-created Telenor subsidiaries. According

to the court ruling, each of these subsidiaries would be eligible for a board seat, thus retaining Telenor's five seats on the nine-seat board.

15. (SBU) A Kiev-based lawyer told EconOff that the October 3 decision was unlikely to set a specific legal precedent, since the judgment appeared based on a strained interpretation of KyivStar company bylaws. He noted that assessing the full legal ramifications would have to await publication of the court's decision, which usually occurs from several days to two weeks after proceedings. He warned, however, that the decision dramatically underlined the sorry state of the Ukrainian judiciary. Telenor executives admitted, in a September 20 meeting with Econ Counselor, that Ukrainian law on board seat distribution was contradictory and that it could be read as condoning the "one investor, one seat" interpretation. One U.S. contact with long experience in Kyiv told Econ Counselor he believed Telenor's case may have been hurt by the relative inexperience of its legal team in litigation, as opposed to the well-known litigators hired by Alfa Group for this case.

16. (SBU) Comment. Ukraine is known for the creative way in which corporate raiders use the court system and the often contradictory legal regime to support complex takeover schemes. The current decision, however, is notable in that it places a Supreme Court stamp of approval on one type of legal manipulation. Many in the business community here fear the decision may encourage business predators to attempt even more audacious schemes in the future. The decision will likely damage the investment climate by strengthening investor perceptions that Ukrainian courts are weak and unpredictable, while casting doubt on the inviolability of contracts in Ukraine. End Comment.

TAYLOR